

REPORT OF EXAMINATION
OF THE
ALLIANZ GLOBAL RISKS US
INSURANCE COMPANY
AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California

Filed June 10, 2005

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Los Angeles, California
April 20, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

ALLIANZ GLOBAL RISKS US INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 2350 Empire Avenue, Burbank, California 91504.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1999. This examination covers the period from January 1, 2000 through December 31, 2003. This examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate

records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; accounts and records; and sales and advertising.

This examination was conducted concurrently with the examination of the Company's wholly-owned subsidiaries, Allianz Underwriters Insurance Company and Fireman's Fund Insurance Company.

COMPANY HISTORY

The Company is wholly-owned by Allianz of America, Inc. (AZOA). Effective November 1, 1997, AZOA contributed its investments in Fireman's Fund Insurance Company (FFIC), Jefferson Insurance Company (JIC) and Allianz Underwriters Insurance Company (AUIC) to the Company. The aggregate book value of the contribution was \$2.9 billion. Under this new organizational structure, FFIC, JIC, and AUIC continue to report directly to AZOA.

Effective July 9, 2003, the Company changed its name change from Allianz Insurance Company to Allianz Global Risks US Insurance Company.

The following is a reconciliation of the gross paid-in and contributed surplus account and a brief discussion, for the period under examination and activity in 2004:

| <u>Note</u> | <u>Description</u> | <u>Amount</u> |
|-------------|--------------------------------------|--------------------------|
| | Balance December 31, 1999 | \$ 2, 465,409,916 |
| (1) | Reduction of Surplus – 2000 | (234,585,678) |
| (2) | Keep Well Agreement – 2001 | 575,000,000 |
| (3) | FFIC Promissory Notes – 2001 | 1,000,000,000 |
| (4) | Pass Through Capital Dividend – 2001 | 166,000,000 |
| (5) | AZ Life Preferred Stock - 2002 | 312,000,009 |
| (2) | Keep Well Agreement Additions – 2002 | 50,000,000 |

| | | |
|--------------------|---------------------------------------|--------------------------------|
| (6) | Preferred Stock Issuance – 2002 | 1,099,882,979 |
| <u>Note</u> | <u>Description</u> | <u>Amount</u> |
| | Additional Preferred Stock Issuance – | 699,925,532 |
| (7) | 2002 | |
| | Balance December 31, 2003 | <u>\$ 6,133,632,758</u> |
| (8) | Reduction of surplus – 2004 | <u>(404,452,006)</u> |
| | Balance December 31, 2004 | <u>\$ 5,729,180,752</u> |

(1) On July 24, 2000, the California Department of Insurance (CDI) approved a \$234,585,678 cash dividend distribution, which was paid on July 25, 2000. The transaction was reflected in the Company's 2000 Annual Statement as a reduction of gross paid-in and contributed surplus.

(2) As approved by the CDI on December 27, 2001, under the terms of a permitted accounting practice, a Keep Well Commitment (Commitment) was issued by Allianz Aktiengesellschaft (AZAG), the Company's ultimate parent, in favor of the Company effective as of September 28, 2001. Under the terms of the Commitment, AZAG agreed to contribute sufficient cash to the Company to permit the Company to meet its payment obligations with respect to losses incurred by the Company as a result of the September 11, 2001 attack on the World Trade Center and the U.S. Pentagon buildings. In conjunction with this Commitment, the Company recorded a recoverable due from AZAG in the amount of \$625 million (\$575 million in 2001 and \$50 million in 2002) and credited gross paid-in and contributed surplus in a like amount. As of year-end 2002, the Company has received \$115 million from AZAG under the terms of the commitment. The balance of \$510 million remains on the Company's books to fund future loss and loss adjustment expense payments.

(3) Effective September 28, 2001, the Company received approval from the CDI under a permitted accounting practice to record a \$1 billion surplus contribution to Fireman's Fund Insurance Company (FFIC). On September 28, 2001, AZAG and certain subsidiaries of AZAG issued a total of six promissory notes in the aggregate amount of \$1 billion. The one note issued by AZAG in the amount of \$180 million was in favor of AZOA; whereas the five notes issued by the subsidiaries totaling \$820 million (subsidiary notes) were in favor of AZAG. In a series of same-day transactions which also transpired on September 28, 2001, FFIC was assigned all right to and

interest in the aforementioned six promissory notes. Under the terms of the permitted accounting practice, the AZAG note is to be secured by a pledge of marketable securities equal to 120% of the face value of the note. Each subsidiary note is guaranteed by AZAG, which guaranty is to be secured by a pledge of marketable securities equal to 120% of the face amount of each note. The pledged securities are to be held in trust with Dresdner Bank under share pledge agreements. All six notes are to bear an interest rate of 5.19% and mature on September 28, 2006.

(4) On June 28, 2001, the proceeds of a \$166 million dividend were wire transferred to FFIC.

(5) Effective June 5, 2002, Allianz Life Insurance Company issued 8,909,195 Class A, Series A Preferred Shares of stock to Allianz of America, Inc. (AZOA) for a total consideration of \$312 million. AZOA distributed the stock to the Company (3,569,389 shares) and FFIC (5,339,806 shares). The CDI approved this transaction in June 2002.

(6) On September 19, 2002, the Company received approval from the CDI under a permitted accounting practice to sell and issue 250,000 shares of Class A, Series A Preferred Stock. Of the 250,000 shares, 117,021 were issued to AZOA on September 30, 2002 for \$1.1 billion. In consideration for the shares, AZOA assigned to the Company the right to receive \$1.1 billion of the premiums due from FFIC. Under the terms of this transaction, AZAG and FFIC entered into a loss portfolio agreement under which FFIC agreed to pay AZAG \$1.1 billion in premiums. The right to receive the \$1.1 billion premium under the loss portfolio agreement with FFIC was then assigned from AZAG to AZOA. In exchange for the 117,021 shares of preferred stock with a reported valuation of \$1.1 billion, AZOA transferred to the Company the right to receive the \$1.1 billion of premiums due from FFIC. In September 2002, the Company assigned its right to the \$1.1 billion of premium due from FFIC to FFIC. As a result, FFIC's \$1.1 billion premium liability under the loss portfolio agreement was completely offset and the Company's carrying value of its FFIC common stock increased by \$1.1 billion. A review of these notes and the related permitted accounting practices was made in conjunction with the concurrent examination of FFIC.

(7) On December 30, 2002, under the terms of a permitted accounting practice, the Company issued 74,468 additional shares of its Class A Series A preferred stock to AZOA for a purchase price of

\$700 million. Of the \$700 million received by the Company from AZOA, \$500 million of the proceeds were wire transferred to FFIC as a cash contribution.

(8) In April 2004, the Company received \$63 million from AZOA and declared a pass through distribution to FFIC. The Company received approval from the CDI to treat this as a capital contribution.

On November 23, 2004, the Company received a distribution of gross paid-in and contributed surplus from FFIC in the aggregate amount of \$495 million comprised of 5,339,806 shares of preferred stock of Allianz Life Insurance Company of North America (Allianz Life) with a statutory value of \$215 million along with two intercompany notes assigned to FFIC with an aggregate statutory value of \$280 million. The \$280 million of intercompany notes consisted of a \$100 million note from Allianz Insurance Company of Canada and \$180 million note issued by Allianz Nederland NV, a subsidiary of AZAG.

The Company, in turn, declared a pass through distribution of a \$280 million preferred share dividend (with \$100 million payable to Allianz Life (an affiliate) and \$180 million payable to AZOA) and a \$187 million common dividend to AZOA, resulting in \$28 million as an unrealized capital gain.

All of the above transactions were reflected as gross paid-in and contributed surplus in 2004 (\$404.5 million).

Permitted Accounting Practices

Permitted accounting practices, which in general constitute a departure from statutory accounting principles and are approved for one year at a time (continuance must be approved each year), were granted the Company by the CDI in 2001 (\$1.575 billion) and 2002 (\$1.850 billion). These permitted practices, as previously discussed, increased the Company's gross paid-in and contributed surplus by \$2.725 billion.

As of December 31, 2003, remaining permitted accounting practices included in the Company's financial statements had the effect of increasing surplus by 89% (\$1.6 billion).

The following is a reconciliation of the Company's capital and surplus between the National Association of Insurance Commissioners' statutory accounting practices (NAIC SAP) and the permitted accounting practices prescribed by the CDI as of December 31, 2003:

| Description | December 31, 2003 |
|---|-------------------------|
| Statutory capital and surplus per statutory financial statements | \$ 3,384,652,276 |
| Effect of permitted accounting practice of including notes contributed by AZAG to FFIC as surplus contributions (*) | (1,000,000,000) |
| Effect of permitted accounting practice of recording structural settlement loss reserves at a discount for FFIC (*) | (237,745,058) |
| Effect of permitted accounting practice of World Trade Center Keep Well Commitment | <u>(360,429,111)</u> |
| Statutory surplus in accordance with NAIC SAP | <u>\$ 1,786,478,107</u> |

(*) reflected in common stock of subsidiary (FFIC)

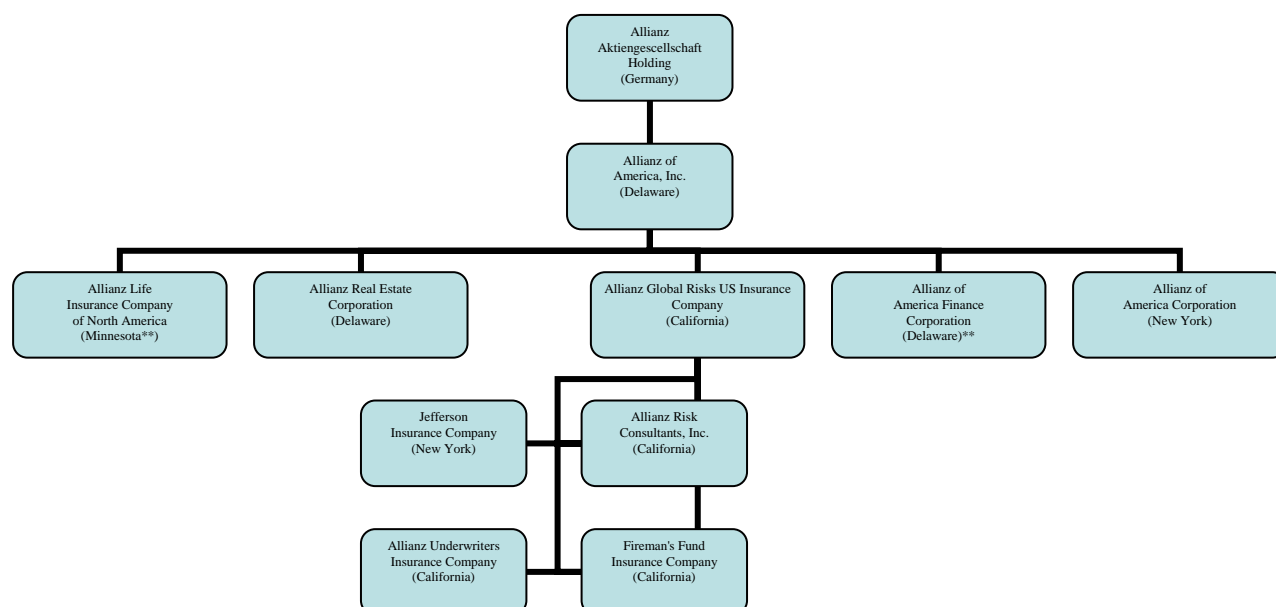
On December 15, 2004, the Company and FFIC applied for a renewal and received an approval from the CDI to extend the remaining balance of permitted accounting practices (a total of \$1.3 billion) to December 31, 2005.

It was noted that the Company failed to disclose these permitted accounting practices as required by Statements of Statutory Accounting Practices (SSAP) No. 1. SSAP No. 1 states, in part, that insurers must disclose in their financial statements the use of accounting practices which depart from NAIC statutory accounting practices and procedures. It is recommended that the Company comply with SSAP No. 1 and disclose its permitted accounting practices in all future financial statements.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Allianz of America, Inc. (AZOA), a Delaware holding company. The ultimate controlling entity is Allianz Aktiengesellschaft Holding, Berlin and

Munich. The following abridged organizational chart depicts the Company's relative position within the holding company structure (all ownership is 100%):



Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2003 follows:

Directors

Name and Residence

Stephan A. Schleisman
Munich, Germany

Kevin R. Callahan(*)
Kenilworth, Illinois

Paul D. Kaduk
Thousand Oaks, California

Principal Business Affiliation

Chairman of the Board
Allianz Global Risks US Insurance
Company

President and Chief Executive Officer
Allianz Global Risks US Insurance Company
Allianz Underwriters Insurance Company

Executive Vice President, Secretary
and Treasurer
Allianz Global Risks US Insurance
Company
Allianz Underwriters Insurance Company

Directors (cont.)

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|--|---|
| Jan Richard Carendi Gmund Waakirchen, Germany | Member of Board of Management Allianz AG |
| Paul M. Saffert Novato, California | Chief Financial Officer Allianz of America |

Principal Officers

| <u>Name</u> | <u>Title</u> |
|--|--|
| Kevin R. Callahan (*) Dennis L. Raab (**) | President and Chief Executive Officer Senior Vice President, Chief Financial Officer and Treasurer |
| Edman Lee Chin | Vice President and Controller |
| Frank Kwon | Vice President and Actuary |
| Ronald M. Clark | Assistant Secretary |
| Brian G. Daly | Senior Vice President |
| Eric H. Joost | Senior Vice President |
| Brent Sorenson | Senior Vice President |

(*) resigned as President and Chief Executive Officer on December 3, 2004 and replaced by Tom Geissler

(**) resigned as Executive Vice President, Chief Financial Officer and Treasurer on March 9, 2005 and replaced by Norbert Lommer

Management Agreements

Investment Advisory Agreement: Effective May 1, 1980 and amended January 1, 1991, the Company appointed Allianz Investment Corporation, an affiliate, as its investment advisor with respect to the management of its investment portfolio. Compensation is based on the assets under supervision. The following is the amount paid by the Company for these services during the examination period:

| <u>Year</u> | <u>Amounts</u> |
|-------------|----------------|
| 2000 | \$495,065 |
| 2001 | \$510,972 |
| 2002 | \$312,210 |
| 2003 | \$479,273 |

Service Agreement: Effective April 1, 1991, the Company entered into a Service Agreement with its subsidiary, Fireman's Fund Insurance Company (FFIC), in which FFIC provides legal, risk management, corporate audit functions, loss control, premium audit functions, and mainframe computer resources. Reimbursement is based on actual costs. The following is the amount paid by the Company for these services during the examination period:

| <u>Year</u> | <u>Amounts</u> |
|-------------|----------------|
| 2000 | \$65,785 |
| 2001 | \$59,939 |
| 2002 | \$50,239 |
| 2003 | \$79,220 |

Executive and Professional Service Agreement: This agreement was effective January 1, 1993 and is subject to annual renewal. Under the terms of the agreement, the Company provides Allianz Underwriters Insurance Company with the services of its Chairman and Executive Vice President of Finance, at an annual rate of compensation equal to a fixed percentage of their salaries including secretarial and support staff. The Company also provides the following departmental services: actuarial, accounting, administrative, corporate affairs, communications, financial, internal audit, electronic data processing, and property and casualty claims services. The following is the amount received by the Company as compensation for these services during the examination period:

| <u>Year</u> | <u>Amounts</u> |
|-------------|----------------|
| 2000 | \$4,429,623 |
| 2001 | \$2,599,196 |
| 2002 | \$1,363,564 |
| 2003 | \$5,723,015 |

Contract for Property Loss Control Services: This agreement was effective April 1, 1995 and is subject to annual renewal. Under the terms of the agreement with its affiliate, Allianz Risk Consultants, Inc. (ARC), ARC provides on-site property loss control services with respect to certain accounts. The Company pays ARC an amount equal to an hourly charge based upon ARC's cost to provide such services. The following are the amounts paid by the Company for these services during the examination period:

| <u>Year</u> | <u>Amounts</u> |
|-------------|----------------|
| 2000 | \$2,784,180 |
| 2001 | \$3,341,676 |
| 2002 | \$3,466,727 |
| 2003 | \$4,428,054 |

Tax Reimbursement Agreement: The Company and its parent file a consolidated federal income tax return under the terms of a Tax Reimbursement Agreement. The Company's tax liability, under the terms of this agreement, is the same as it would have been had it filed on a separate stand-alone basis.

During the examination period the Company's parent, AZOA, provided the Company with certain services without a formal written agreement. It is recommended that the Company prepare and submit a written agreement to the California Department of Insurance for approval in compliance with California Insurance Code Section 1215.5. The following are the amounts paid by the Company during the examination period for these services:

| <u>Year</u> | <u>Amounts</u> |
|-------------|----------------|
| 2000 | \$273,798 |
| 2001 | \$354,324 |
| 2002 | \$453,830 |
| 2003 | \$692,622 |

TERRITORY AND PLAN OF OPERATION

As of December 31, 2003, the Company was licensed to write various property and casualty coverages in all 50 states and the District of Columbia and Puerto Rico. The Company is also a reinsurer of business written in other countries. During 2003, the Company wrote direct premiums of \$652.2 million. Of the total direct premiums written, \$77.3 million (11.9%) was written in California. The Company wrote no more than 9% of its direct business in any one of the remaining 49 states.

The Company's marketing efforts have been in two specialties, global business and special property coverages. Global business consists of commercial property and casualty business. Insurance coverage for business in the United States is written on a direct basis, while insurance coverage in

other countries is as a reinsurer. The majority of the alien-assumed business is commercial property business written by, and assumed from, alien affiliates. Special property coverages consists of builders' risks for large construction operations and most property risks in the surplus lines market on a primary, excess or full-limits basis.

The Company at April 1, 2002 withdrew from writing casualty insurance with the exception of business that was placed by Allianz affiliates. Discontinued operations, mainly workers compensation, produced a \$17.7 million statutory underwriting loss.

Business is generated by approximately 50 independent agents and brokers. All the claims processing is handled at the Company's home office in Burbank, California. Underwriting and policy maintenance is also handled in the Company's home office and at its branch offices located in Atlanta, Georgia; Chicago, Illinois; and New York, New York.

LOSS EXPERIENCE

The following is a summary of the Company's loss experience, as reported by the Company, for the last five years:

| Description | Year/Amounts (000 Omitted) | | | | |
|---|----------------------------|------------|-------------|-------------|------------|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| Net Premiums Earned | \$ 87,076 | \$ 86,726 | \$ 62,606 | \$ 54,949 | \$ 49,757 |
| Net Losses and Loss Expenses Incurred | 119,054 | 97,114 | 729,386 | 202,844 | 49,158 |
| Net Other Underwriting Expense Incurred | 13,991 | 11,014 | 10,544 | (488) | 21,602 |
| | | | | | |
| Net Loss from Underwriting | \$(45,969) | \$(21,402) | \$(677,324) | \$(147,407) | \$(21,003) |
| Net Investment and Other Income (Loss) | 496,934 | 239,312 | 33,123 | (31,538) | 67,868 |

| | | | | | |
|-------------------|-----------|-----------|-------------|-------------|----------|
| Net Income (Loss) | \$450,965 | \$217,910 | \$(644,201) | \$(178,945) | \$46,865 |
|-------------------|-----------|-----------|-------------|-------------|----------|

As reflected above, the Company reported substantial underwriting losses in 2001 and 2002. The reported losses were primarily the result of losses incurred from the September 11, 2001 terrorist attacks on the World Trade Center and the United States Pentagon buildings. As previously noted in this report, the Keep Well Commitment will ultimately provide full reimbursement (net of all other reinsurance) for the losses associated with the terrorist attacks. As a result, the initial reporting of underwriting losses for the terrorist attacks will reduce to zero after the Company receives all reimbursements due under the terms of the Commitment. In the aggregate, the five years of underwriting losses totaled \$913.1 million, the investment and other income was \$805.7 million, which resulted in a total five-year net loss of \$107.4 million.

Although not included in the above loss experience amounts, the Company reported unrealized capital losses (as a direct charge to surplus) of \$1.1 billion and \$1.5 billion in 2001 and 2002, respectively. These unrealized losses were primarily the result of increases in reserves for asbestos and environmental claims and write-downs of securities by the Company's wholly-owned subsidiary, Fireman's Fund Insurance Company (and related adjustments to the subsidiary's unassigned surplus).

At year-end 2004, the Company reported a net underwriting loss of \$23.5 million and a net income of \$30.4 million.

REINSURANCE

Reinsurance Pooling Agreement

Effective January 1, 1987, the Company entered into a reinsurance pooling agreement with its wholly-owned subsidiary, Allianz Underwriters Insurance Company (AUIC). The purpose of the agreement is to pool, through reinsurance, the results of underwriting operations between the Company and AUIC. Under the terms of the agreement, the Company assumes 100% of the following (net of other reinsurance) from AUIC: unearned premium reserves; claim reserves

(including losses and loss adjustment expenses); reserves for incurred but not reported losses; net written premiums; net payment of losses; loss adjustment expenses; and underwriting expenses. These amounts, together with amounts directly attributable to the Company, represent the pooled business of which 5.2% is retroceded to AUIC. Effective September 30, 2003, under the new Gross Pooling Agreement, the Company reinsures 100% of the gross business of AUIC. AUIC transfers all its ceded reinsurance to the Company and after combining all such business and reserves, the Company cedes 2.0% of the combined net results back to AUIC. .

Assumed

Other than the reinsurance pooling agreement with its subsidiary, the Company assumes reinsurance through its foreign affiliates in its global property and energy business (global business). As of year-end 2003, the Company assumed premium of approximately \$109 million and carried case and loss adjustment expense reserves of \$831 million. The assumed global business was written through facultative reinsurance.

Ceded

The Company has designed its reinsurance program to limit its retention to \$20 million for all risks insured with the exception of builders' risk and energy, which the Company retains \$1 million. In addition to the reinsurance pooling agreement, the Company's reinsurance program is summarized as follows:

| Type of Contract | Reinsurer's Name | Coverage | Reinsurer's Limits | Company's Retention |
|--|---|---------------|-----------------------------------|--|
| Property Lines | | | | |
| Property Quota Share | Allianz Global Risks Reinsurance Co. | Property | 90% of \$200 million | 10% of \$200 million |
| Property Lines (Builders' Risk) | | | | |
| Technical Quota Share | Allianz Global Risks Reinsurance Co. | Builders Risk | 90% of \$100 million | 10% of \$100 million |
| Technical Per Risk Excess of Loss (Runoff) | Allianz Global Risks Reinsurance Co. and Munich Reinsurance Co. | | \$1.5 million each and every loss | \$500,000 Probable Maximum Loss per risk |
| Casualty Lines | | | | |

| Type of Contract | Reinsurer's Name | Coverage | Reinsurer's Limits | Company's Retention |
|--|--------------------------------------|-----------|--|---------------------|
| Casualty Quota Share (Runoff) | Allianz Global Risks Reinsurance Co. | Liability | 90% of \$10 million | 10% of \$10 million |
| Energy (includes property coverage for drilling plant, oil refinery, power plant, etc.) | | | | |
| Energy Quota Share | Allianz Global Risks Reinsurance Co. | Property | 90% of €100 million | 10% of €100 million |
| All Lines | | | | |
| Stop Loss | Allianz Global Risks Reinsurance Co. | All Lines | 200% of net earned premium in excess of 120% net retention (net loss incurred plus net original costs divided by net earned premium) | |

The following is a summary of reinsurance recoverable as reported by the Company as of December 31, 2003, under the terms of its ceded reinsurance agreements:

| <u>Description</u> | <u>Amount</u> |
|--------------------------------------|------------------------|
| Reinsurance Recoverable on: | |
| Paid Losses | \$36,877,000 |
| Paid Loss Adjustment Expenses | 12,595,000 |
| Unpaid Losses and LAE | <u>2,087,142,000</u> |
| Subtotal – Loss and LAE Recoverables | 2,136,614,000 |
| Unearned Premiums | <u>273,495,000</u> |
| Total Recoverables | <u>\$2,410,109,000</u> |

A significant amount of the loss and loss adjustment expense recoverables noted above are due the Company from its various unauthorized affiliated reinsurers. One of the major reinsurers is the Company's ultimate parent, Allianz AG. The Company maintains letters of credit and trust accounts to secure its recoverables from unauthorized reinsurers.

Effective January 1, 2002, the Company entered into a Stop Loss Reinsurance Agreement (Stop Loss) with its affiliate Allianz Global Risks Reinsurance Co. (AGR Re). The Stop Loss provides protection on all lines of business for up to 200% of net earned premium in excess of the Company's net retention of 120% on net loss incurred plus net original costs divided by net earned premium (combined ratio). The Company reported no reserve credits on this agreement as of year-end 2003.

As of year-end 2003, the Company established a reserve for unrecoverable reinsurance in the amount of \$74.4 million. During 2003, the Company also wrote off \$28.4 million of reinsurance recoverables from various non-affiliated authorized and unauthorized reinsurers.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders
from December 31, 1999 through December 31, 2003

Reconciliation of Examination Changes as of December 31, 2003

Statement of Financial Condition
as of December 31, 2003

| <u>Assets</u> | Ledger and No ledger <u>Assets</u> | <u>Assets Not Admitted</u> | <u>Net Admitted Assets</u> | <u>Notes</u> |
|--|--|--------------------------------|--------------------------------|--------------|
| Bonds | \$ 798,474,954 | \$ | \$ 798,474,954 | |
| Stocks: | | | | |
| Preferred stocks | 136,457,740 | | 136,457,740 | |
| Common stocks | 3,094,169,571 | 657,821,603 | 2,436,347,968 | (1) |
| Cash and short-term investments | 261,389,749 | | 261,389,749 | |
| Other invested assets | 8,061,085 | | 8,061,085 | |
| Receivable for securities | 893,407 | | 893,407 | |
| Agents' balances or uncollected premiums: | | | | |
| Premiums and agents' balances in course of collection | 7,854,177 | 16,800,435 | (8,946,258) | (2) |
| Premiums, agents' balances and installments booked but deferred and not yet due | 18,379,540 | | 18,379,540 | |
| Funds held by or deposited with reinsured companies | 14,082,220 | | 14,082,220 | |
| Reinsurance recoverable on loss payments | 49,471,520 | | 49,471,520 | |
| Net deferred tax asset | 308,448,219 | 274,420,726 | 34,027,493 | (3) |
| Guaranty funds receivable or on deposit | 726,896 | | 726,896 | |
| Interest, dividends, and real estate income due and accrued | 10,944,638 | | 10,944,638 | |
| Net adjustments in assets and liabilities due to foreign exchange rates | 2,770,813 | | 2,770,813 | |
| Receivable from parent, subsidiaries and affiliates | 2,138,790 | | 2,138,790 | |
| Equities and deposits in pools and associations | 2,590,936 | | 2,590,936 | |
| Other assets nonadmitted | 13,151,805 | 13,151,805 | | |
| Aggregate write-ins for other than invested assets | <u>362,675,025</u> | <u>0</u> | <u>362,675,025</u> | (4) |
| Total assets | <u>\$5,092,681,085</u> | <u>\$962,194,569</u> | <u>\$4,130,486,516</u> | |
| <u>Liabilities, Surplus and Other Funds</u> | | | | |
| Losses | | | \$ 728,487,411 | (5) |
| Loss adjustment expenses | | | 163,211,570 | (5) |
| Commissions payable, contingent commissions and other similar | | | 5,934,417 | |
| Other expenses | | | 14,754,375 | |
| Taxes, licenses and fees | | | 11,337,598 | |
| Federal and foreign income taxes | | | 0 | |
| Unearned premiums | | | 23,076,169 | |
| Ceded reinsurance premiums payable | | | 110,121,506 | |
| Funds held by company under reinsurance treaties | | | 63,804,566 | |
| Amounts withheld or retained by company for account of others | | | 20,244,092 | |
| Provision for reinsurance | | | 25,666,318 | (6) |
| Payable to parent, subsidiaries and affiliates | | | 1,277,810 | |
| Payable for securities | | | 124,732,481 | |
| Aggregate write-ins for liabilities | | | <u>111,007,530</u> | |
| Total liabilities | | | 1,403,655,843 | |
| Common capital stock | | \$ 10,000,000 | | |
| Preferred capital stock | | 191,489 | | |
| Gross paid-in and contributed surplus | | 6,133,632,758 | | |
| Unassigned funds (surplus) | | <u>(3,416,993,574)</u> | | |
| Surplus as regards policyholders | | | <u>2,726,830,673</u> | |
| Total liabilities, surplus and other funds | | | <u>\$4,130,486,516</u> | |

Underwriting and Investment Exhibit
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|-------------------|-------------------|
| Premiums earned | | \$ 49,756,676 |
| Deductions: | | |
| Losses incurred | \$ 26,462,744 | |
| Loss expense incurred | 22,694,901 | |
| Other underwriting expenses incurred | <u>21,602,273</u> | |
| Total underwriting deductions | | <u>70,759,918</u> |
| Net underwriting loss | | (21,003,242) |

Investment Income

| | | |
|------------------------------|------------------|------------|
| Net investment income earned | 52,123,623 | |
| Net realized capital gains | <u>5,119,741</u> | |
| Net investment gain | | 57,243,364 |

Other Income

| | | |
|--|-------------------|----------------------|
| Net loss from agents' balances charged off | (1,408,772) | |
| Aggregate write-ins for miscellaneous income | <u>11,505,791</u> | |
| Total other income | | <u>10,097,019</u> |
| Net income before federal income taxes | | 46,337,141 |
| Federal income taxes incurred | | <u>(527,996)</u> |
| Net income | | <u>\$ 46,865,137</u> |

Capital and Surplus Account

| | | |
|--|------------------|-------------------------|
| Surplus as regards policyholders, December 31, 2002 | | \$ 2,644,992,732 |
| Net income | \$ 46,865,137 | |
| Net unrealized capital gains | 18,350,491 | |
| Change in net unrealized foreign exchange capital gain | 2,660,223 | |
| Change in net deferred income tax | 15,673,494 | |
| Change in nonadmitted assets | (17,714,360) | |
| Change in provision for reinsurance | 14,802,956 | |
| Cumulative effect of changes in accounting principles | <u>1,200,000</u> | |
| Change in surplus as regards policyholders | | <u>81,837,941</u> |
| Surplus as regards policyholders, December 31, 2003 | | <u>\$ 2,726,830,673</u> |

Reconciliation of Surplus as Regards Policyholders
from December 31, 1999 through December 31, 2003

Surplus as regards policyholders, December 31, 1999,
per Examination

\$3,567,517,317

| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> |
|--|-----------------------------|----------------------------|
| Net loss | \$ | \$ 558,371,196 |
| Net unrealized capital losses | | 3,567,664,396 |
| Change in net unrealized foreign exchange capital gain | 1,942,679 | |
| Change in net deferred income tax | 267,329,730 | |
| Change in nonadmitted assets | | 246,810,428 |
| Change in provision for reinsurance | 17,659,060 | |
| Cumulative effect of changes in accounting principles | 15,059,099 | |
| Capital changes: Paid-in | 191,489 | |
| Surplus adjustments: Paid-in | 3,668,222,859 | |
| Dividends to stockholders | | 200,000,000 |
| Aggregate write-ins for losses in surplus | <u> </u> | <u>238,245,540</u> |
| Totals | <u>\$3,970,404,916</u> | <u>\$4,811,091,560</u> |

Net decrease in surplus as regards policyholders

(840,686,644)

Surplus as regards policyholders, December 31, 2003,
per Examination

\$2,726,830,673

Reconciliation of Examination Changes
as of December 31, 2003

| | <u>Per Company</u> | <u>Per Examination</u> | <u>Surplus Increase (Decrease)</u> | <u>Notes</u> |
|--|------------------------|----------------------------|--|--------------|
| <u>Assets:</u> | | | | |
| Common stocks | \$ 3,094,169,571 | \$ 2,436,347,968 | <u>\$ (657,821,603)</u> | (1) |
| Net decrease to surplus as regards policyholders | | | (657,821,603) | |
| Surplus as Regards Policyholders, December 31, 2003 per Company | | | <u>3,384,652,276</u> | |
| Surplus as Regards Policyholders, December 31, 2003 per Examination | | | <u>\$ 2,726,830,673</u> | |

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Common Stocks

The Company owns all of the outstanding shares of Fireman's Fund Insurance Company (FFIC) and carried its common stock investment in FFIC as of year-end 2003 at \$2.9 billion using the statutory equity method. Based on the results of the examination of FFIC by the California Department of Insurance, which was done concurrently with this examination, the Company's common stock carrying value has been reduced by \$657.8 million.

(2) Premiums and Agents' Balances in Course of Collection

Pursuant to Statement of Statutory Accounting Principles (SSAP) 6 and 62, the ageing of original and deposit premiums are governed by the effective date of the policy. In addition, reinsurance premiums more than 90 days overdue shall be nonadmitted. A review of the Company's procedures for ageing a portion of its affiliated assumed global premiums receivable disclosed that the Company failed to nonadmit over 90-day past due premiums in its year-end 2002 Annual Statement. However, the Company was in compliance with the SSAP in 2003.

(3) Federal Income Tax Recoverable

The Company sold \$57 million of its nonadmitted deferred tax assets to its parent, Allianz of America, Inc. (AZOA), on December 31, 2001, for \$50.3 million cash. The sale was approved by the California Department of Insurance (CDI) on March 21, 2002, with effective date of December 31, 2001, pursuant to an "Agreement for Purchase and Sale of Deferred Tax Assets between the Company and AZOA." Under the terms of the agreement, the settlement of the deferred tax assets that the Company is due under the tax sharing agreement are to be retained by AZOA. As of December 31, 2003, AZOA has realized \$24.6 million of the \$57 million of deferred tax assets under the agreement.

(4) Aggregate Write-ins for Other Than Invested Assets

Included in the captioned asset is \$360.4 million due from the Company's ultimate parent for losses suffered by the Company as a result of the September 11, 2001 terrorist attack. As approved by the CDI on December 27, 2001, under the terms of a permitted accounting practice, a Keep Well Commitment (Commitment) was issued by Allianz Aktiengesellschaft (AZAG), the Company's ultimate parent, in favor of the Company effective as of September 28, 2001. Under the terms of the Commitment, AZAG agreed to effect the contribution of sufficient cash to the Company to permit the Company to meet its payment obligations (net losses and loss adjustment expenses) as they come due with respect to loss and loss adjustment expenses recognized by the Company in its statutory financial statements attributable to the September 11, 2001 attack on the World Trade Center and the U.S. Pentagon buildings. The original Commitment provided that in no event shall the supported reserves, or the amount of collateral called for under the Commitment, exceed \$300 million. Subsequent amendments, however, have increased the Commitment from \$300 million to \$625 million.

The year-end balance is reflective of the initial Commitment amount (\$575 million), plus subsequent increases (\$50 million), less payments received from AZAG. As of year-end 2003, the Company has received a total of \$262 million from AZAG under the terms of the commitment. This asset balance exactly offsets net loss and loss adjustment expense reserve liabilities reported by the Company in its statutory financial statements for losses incurred by the Company as a result of the September 11, 2001 attack.

In accordance with the terms of the Commitment, AZAG's obligation is secured by a pledge of publicly traded securities for the benefit of the Company, which are held in trust by Dresdner Bank, a subsidiary of AZAG, in accounts maintained by AZAG and its affiliate, AZ-Arges. In a letter dated January 16, 2002, the CDI advised the Company that the market value of the pledged securities must at all times equal at least 100% of the Commitment amount. As the result of a direct verification provided by Dresdner Bank and a review of the market values, the pledged securities were found to have a year-end market value of approximately \$570.2 million which exceeds the Commitment amount of \$360.4 million.

(5) Losses and Loss Adjustment Expenses

The CDI, pursuant to California Insurance Code (CIC) Section 733(g), retained an independent actuary, for the purpose of providing a full actuarial evaluation of the Company's loss and loss adjustment expense reserves as of December 31, 2003. Based on the analysis by the independent actuary, and a review of their work by a Casualty Actuary from the CDI, the Company's reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination report.

Although the overall reserves were determined to be reasonably stated based on the information available at the date of this examination report, the Company has actual and/or potential material loss exposures including the following:

World Trade Center Terrorist Attack: As previously noted in this examination report, the Company suffered significant losses (on a direct basis, before reinsurance and the Keep Well Commitment) as a result of the September 11, 2001 terrorist attack on the World Trade Center (WTC). On a direct basis, the Company has incurred losses and loss adjustment expenses of \$2.9 billion through year-end 2003. Net of reinsurance (\$2.3 billion), the Company's incurred losses and loss adjustment expenses as of year-end 2003 is \$625 million. Under the terms of the Keep Well Commitment, the Company's ultimate parent is obligated to reimburse the Company for the remaining \$625 million of net losses and loss adjustment expenses.

Although the Company's ultimate parent is obligated under the Keep Well Commitment to reimburse the Company (after all other reinsurance) for losses it sustains as a result of the September 11, 2001 terrorist attack, there are two other contingencies which could materially impact the ultimate losses resulting from this attack. First, recent court rulings have determined that language in the policies written by the Company covering the WTC buildings could support either a one or two occurrence interpretation. The Company has two policies impacted by the two-occurrence ruling. The gross exposure for the two policies, two occurrences combined is \$655 million and the net exposure is \$106 million. Under the terms of the Keep Well Commitment, the Company's

ultimate parent is obligated to reimburse the Company for the remaining \$106 million of net losses and loss adjustment expenses.

Secondly, Deutsche Bank, A.G. (Deutsche) has recently filed suit against the Company and AXA Re Property & Casualty Insurance Company (AXA) for their refusal to pay a total loss claim relating to the September 11, 2001 terrorist attack which damaged the Deutsche Bank building. Two other participants have settled their obligations relating to a negotiated \$1.05 billion total loss claim. The Company is disputing this amount and has requested an appraisal, pursuant to the terms of its policy. In the event that Deutsche is successful, the Company would be obligated to pay 30% of the awarded amount, excluding expenses. The Company recorded reserves of \$270 million gross and \$11 million net as of year-end 2003. The remaining net \$11 million is secured by the Keep Well Commitment. As of the date of this report of examination, settlement of Deutsche claim is still pending.

Roman Catholic Archdiocese Claims: The Company has exposure relating to claims filed against the Roman Catholic Archdiocese of Los Angeles (RCALA) and Orange County Archdiocese (OCA) as well as claims relating to the All American Boys Choir (AABC). The majority of the claims relates to the RCALA and is for accident years from 1978 to 1985 and includes approximately 160 claimants. All of the claims filed against the RCALA, OCA and AABC allege abuse during one or more of the Company's policy periods.

On December 5, 2004, the Company settled the OCA claims for \$100 million. OCA paid 50.567% and the insurance carriers (including the Company) collectively paid 49.433%. The Company had two policies and each policy paid \$500,000 for a total of \$1 million.

As of year end 2003 and 2004 the Company booked gross loss and loss adjustment expense reserves of \$87.5 million and \$135.2 million, respectively, for all of the abuse claims. On a net basis, the Company booked \$16 million and \$25 million, respectively for these claims.

Asbestos and Environmental Claims: As of year-end 2003, the Company reported gross and net reserves for asbestos and environmental (A&E) claims totaling \$194.1 million and \$42.2 million,

respectively. The Company's exposure to A&E losses is primarily through general liability and commercial multi-peril policies written since 1979. The Company completed an asbestos and environmental reserve analysis in 2003, which ultimately reduced the gross reserves by \$20 million. The reduction was related to A&E exposures relating to the Company's commercial multi-peril, products liability and other liability lines and included reserves for accident years 1984 through 2003. As of year-end 2004, the Company reported gross and net reserves for A&E claims totaling \$198.5 million and \$50.5 million, respectively.

(6) Provision for Reinsurance

Effective December 31, 2001 and December 23, 2002, the Company and its subsidiary, Allianz Underwriters Insurance Company (AUIC), sold past due and nonadmitted reinsurance recoverables to its parent, Allianz of America, Inc. (AZOA), under the terms of an Agreement for Purchase and Sale of Nonadmitted and Past Due Reinsurance Recoverables (Agreement). The recoverables sold include amounts due from reinsurers for amounts paid by the Company involving environmental claims, multi-policy claims and multi-year or multi-layer claims.

Although the Agreement between the Company, AUIC and its parent indicated that the sale was without recourse, a condition of the Agreement allowed the Company to repay AZOA in the following year. The sale appears to be in violation of SSAP 18 (transfers and servicing of financial assets and extinguishments of liabilities) Paragraph 35. SSAP 18 states, in part, that "A transfer of receivables with recourse shall not be recognized as a sale but rather, as a financing. A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received." Since the Company repaid AZOA in the following year the transaction was with recourse and should not be recognized as a sale. It was recommended that the Company discontinue the practice of selling past due and nonadmitted reinsurance recoverables unless it is in strict compliance with SSAP No. 18. The Company complied with this recommendation in 2003.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Permitted Accounting Practices – (Page 5): It is recommended that the Company comply with SSAP No. 1 and disclose its permitted accounting practices in all future financial statements.

Management Agreement - (Page 8): It is recommended that the Company prepare and submit a written agreement to the California Department of Insurance for approval in compliance with California Insurance Code (CIC) Section 1215.5.

Provision for Reinsurance – Page (24): It was recommended that the Company discontinue the practice of selling past due and nonadmitted reinsurance recoverables unless it is done in strict compliance with SSAP No. 18. The Company complied with this recommendation in 2003.

Previous Report of Examination

Mortgage Loans on Real Estate (Page 15) It was recommended that the Company comply with CIC Section 1104. The Company complied with the recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Duane Armstrong, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California